

14 January 2019



Events Round-Up

NZ: Building permits (m/m%), Nov: -2.1 vs. 1.5 prev.
AU: Retail sales (m/m%), Nov: 0.4 vs. 0.3 exp.
UK: Industrial production (m/m%), Nov: -0.4 vs. 0.2 exp.
UK: GDP (m/m%), Nov: 0.2 vs. 0.1 exp.
US: CPI (y/y%), Dec: 1.9 vs. 1.9 exp.
US: CPI ex food and energy (y/y%), Dec: 2.2 vs. 2.2 exp.

Good Morning

US equity markets were unchanged on Friday, as risk sentiment continued to recover in the New Year. Global rates moved lower amid more dovish comments from Fed officials. Meanwhile, the NZD rose strongly on growing hopes of a US-China trade deal.

2019 has certainly started off on a more positive note for risk assets, with equity markets moving higher, high yield and investment grade credit spreads tightening and emerging market currencies strengthening. The S&P500 ended Friday unchanged, leaving it up 2.5% on the week and 3.6% year-to-date. It has now recovered 10% from the lows reached on Christmas eve. Similarly, US high yield (i.e. "junk") corporate bond spreads have tightened 82bps this year as the market has scaled back expectations of a US recession.

The improved tone to risk assets has followed increased optimism that the US and China will strike a trade deal, a dovish shift from Federal Reserve officials, and the very strong non-farm payrolls release a week ago which suggested the US economy was not about to fall into an imminent recession. On the trade front, US Treasury Secretary Mnuchin said on Friday that he expected Chinese Vice Premier Liu to travel to the US for trade talks "later in the month" (likely 30-31 January according to the WSJ). Media have reported that Trump is keen to strike a deal to boost US markets.

Rising optimism of a US-China trade deal boosted the CNY on Friday, and consequently the NZD and AUD. The CNY was 0.4% stronger on the day, reaching its highest level against the USD since July last year (USD/CNY is now 6.76). The NZD was the top-performing currency in the G10 on Friday, closing 0.8% higher at 0.6830. The NZD and AUD were the two best performing currencies on the week – both up around 1.5%.

The other key change this year has been the notable shift in rhetoric from the Federal Reserve – in a dovish direction. On Friday afternoon, Fed Vice Chair Clarida noted the softening in global growth and tightening in financial conditions and said "*if these crosswinds are sustained, appropriate forward-looking monetary policy should seek to offset them to keep the economy as close as possible to our dual-mandate objectives of maximum employment and price stability*". Some interpreted the reference to "offset" as implying a willingness to cut rates. Meanwhile, Chicago Fed President Evans noted that the Fed "*can easily wait six months to kind of look at the data and see how things come in*", reinforcing the notion that the Fed is unlikely to hike rates in the first half of this year, if at all.

US rates were lower across the curve on Friday, with the dovish Fed-speak likely assisting the moves. The 10 year US Treasury yield was 4bps lower to 2.70% while the 2 year yield was 3bps lower to 2.54%. The market prices the Fed to be on hold in 2019 with a two-thirds chance of a rate cut by the end of 2020.

In economic data, both headline and core CPI met expectations and there was no immediate market reaction. Core CPI has been 2.2% for the past five months, consistent with the Fed meeting its inflation target. A resumption of US rate hikes is likely to require an increase in US core inflation above target, although there are no signs of that yet.

The US government shutdown continues to rumble on and will start to affect the release of US economic data (e.g. retail sales won't be released this week). The economics unit of S&P estimated that the shutdown had already caused a \$3.6b hit to the US economy by the end of last week, and it will likely start to distort US economic data the longer it drags on.

The USD indices were slightly higher on Friday (DXY +0.15%), but lower on the week. The dovish shift from the Fed this year and improvement in risk appetite has weighed on the USD.

Besides the NZD, the other outperformer on Friday was the GBP, which was boosted by reports that UK cabinet members expected Brexit to be delayed beyond March 29th if PM May's deal fails. The GBP was 0.8% higher to 1.2850, its highest level since late November.

The parliamentary vote on Theresa May's deal is due to

take place on Tuesday, UK time, and it is widely expected to be heavily defeated. May is hoping that EU will provide fresh reassurances over the Irish border on Monday, although it seems doubtful these will have the legal force needed to assuage MPs concerns. There remain a wide range of permutations if the deal fails to pass. Labour is expected to call a vote of no confidence in the government shortly afterwards, although this too is expected to fail. The Sunday Times reported that a cross-party group of backbenchers were plotting take control of the Brexit process in the aftermath of a failed vote, enabling them to suspect Article 50. Volatility in the GBP is likely to be elevated this week.

be speaking on Friday night. US earnings season kicks off on Tuesday, with most of the large US banks reporting as well as Netflix, among others. Locally, the focus is the release of the QSBO tomorrow morning.

nick.smyth@bnz.co.nz

Coming Up

	Period	Cons.	Prev.	NZT
EC Industrial Production (y/y%)	Nov	-2	1.2	23:00

Source: Bloomberg, BNZ.

Elsewhere this week, there is second-tier US data released and New York Fed President John Williams will

Foreign Exchange							Equities				Commodities**				
Indicative overnight ranges (*)				Other FX			Major Indices				Price				
	Last	% Day	Low	High		Last	% Day			Last	% Day	% Year		Last	Net Day
NZD	0.6832	+0.8	0.6779	0.6844	CHF	0.9835	-0.1		S&P 500	2,596	-0.0	-6.8	Oil (Brent)	60.48	-1.9
AUD	0.7215	+0.4	0.7182	0.7235	SEK	8.932	+0.3		Dow	23,996	-0.0	-7.0	Oil (WTI)	51.59	-1.9
EUR	1.1469	-0.3	1.1458	1.1540	NOK	8.536	+0.7		Nasdaq	6,971	-0.2	-4.0	Gold	1289.5	+0.2
GBP	1.2844	+0.8	1.2710	1.2866	HKD	7.839	+0.0		Stoxx 50	3,070	-0.2	-15.0	HRC steel	693.0	-0.3
JPY	108.48	+0.0	108.15	108.60	CNY	6.763	-0.4		FTSE	6,918	-0.4	-11.1	CRB	178.1	-0.3
CAD	1.3267	+0.2			SGD	1.353	+0.1		DAX	10,887	-0.3	-17.8	Wheat Chic.	525.0	+1.0
NZD/AUD	0.9469	+0.3			IDR	14,048	-0.0		CAC 40	4,781	+0.2	-13.3	Sugar	12.78	+0.9
NZD/EUR	0.5957	+1.0			THB	31.94	+0.0		Nikkei	20,360	+1.0	-13.9	Cotton	72.49	-0.5
NZD/GBP	0.5319	+0.1			KRW	1,116	-0.2		Shanghai	2,554	+0.7	-25.5	Coffee	103.9	-0.4
NZD/JPY	74.11	+0.8			TWD	30.78	+0.0		ASX 200	5,775	-0.4	-4.9	WM powder	2860.0	-1.0
NZD/CAD	0.9064	+1.0			PHP	52.04	-0.3		NZX 50	8,960	+0.5	8.7	Australian Futures		
NZ TWI	73.98	+0.6											3 year bond	98.215	0.03
													10 year bond	97.69	0.03
Interest Rates							NZ Government Bonds				NZ Swap Yields				
Rates		Swap Yields		Benchmark 10 Yr Bonds		Last		Last		Last		Last			
	Cash	3Mth	2 Yr	10 Yr	USD	Last	Net Day								
USD	2.50	2.79	2.70	2.72	USD	2.70	-0.04	NZGB 6 05/15/21	1.68	0.01	1 year	1.91	-0.00		
AUD	1.50	2.06	1.90	2.56	AUD	2.31	-0.01	NZGB 5 1/2 04/15/23	1.80	0.01	2 year	1.93	0.01		
NZD	1.75	1.93	1.92	2.63	NZD	2.15	0.00	NZGB 2 3/4 04/15/25	1.99	0.00	5 year	2.18	0.01		
EUR	0.00	0.06	-0.15	0.80	GER	0.24	-0.02	NZGB 4 1/2 04/15/27	2.15	0.00	7 year	2.39	0.00		
GBP	0.75	0.92	1.18	1.47	GBP	1.29	0.02	NZGB 3 04/20/29	2.33	0.00	10 year	2.63	0.00		
JPY	-0.06	-0.07	0.00	0.17	JPY	0.02	-0.01	NZGB 3 1/2 04/14/33	2.50	0.00	15 year	2.89	0.00		
CAD	1.75	1.17	2.26	2.47	CAD	1.96	-0.03	NZGB 2 3/4 04/15/37	2.66	0.00					

* These are indicative ranges from 5pm NZT; please confirm rates with your BNZ dealer

** All near futures contracts, except CRB. Metals prices are CME.

Rates are as of New York close

Source: Bloomberg

Contact Details

Jason Wong

Senior Markets Strategist
+64 4 924 7652

Nick Smyth

Interest Rate Strategist
+64 4 924 7653

National Australia Bank

Ray Attrill

Head of FX Strategy
+61 2 9237 1848

Rodrigo Catril

Senior FX Strategist
+61 2 9293 7109

Gavin Friend

Senior Market Strategist
+44 20 7710 1588

Skye Masters

Head of Fixed Income Research
+61 2 9295 1196

Alex Stanley

Senior Interest Rate Strategist
+61 2 9237 8154

Analyst Disclaimer: The Information accurately reflects the personal views of the author(s) about the securities, issuers and other subject matters discussed, and is based upon sources reasonably believed to be reliable and accurate. The views of the author(s) do not necessarily reflect the views of the NAB Group. No part of the compensation of the author(s) was, is, or will be, directly or indirectly, related to any specific recommendations or views expressed. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Global Markets Division of NAB.

NAB maintains an effective information barrier between the research analysts and its private side operations. Private side functions are physically segregated from the research analysts and have no control over their remuneration or budget. The research functions do not report directly or indirectly to any private side function. The Research analyst might have received help from the issuer subject in the research report.

New Zealand: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person's particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication. **National Australia Bank Limited is not a registered bank in New Zealand.**

USA: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.